

**CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM  
STATEMENT OF INVESTMENT POLICY**

**FOR  
GEOGRAPHIC GUIDELINES FOR INTERNATIONAL EQUITY REAL ESTATE  
INVESTMENT**

**August 18, 2008September 15, 2008**

*This Policy is effective immediately upon adoption and supersedes all previous international real estate policies.*

**I. PURPOSE**

This document sets forth the investment policy ("the Policy") for guidelines for globalthe International Equity Real eEstate iInvestingment Program ("the Program"). The design of this Policy ensures that investors, managers, consultants, or other participants selected by the California Public Employees' Retirement System ("the System") take prudent and careful action while managing the real estate portfolioProgram. Additionally, use of this Policy provides assurance that there is sufficient flexibility in controlling investment risks and returns associated with globalinternational equity real estate investment.

**II. STRATEGIC OBJECTIVE**

The strategic objective of the Geographic Guidelines for Real Estate Investment Policy is to stratify the global universe to allow for clear and efficient diversification of real estate investments. ~~Generating superior risk-adjusted returns compared to the System's Direct Core Equity Real Estate Portfolio is the overriding objective of the Program. The investment selection shall be oriented to achieve the objectives of preservation of capital and diversification of risk. "International" is defined as being any geographic location other than the eight domestic - U.S. NCREIF (National Council of Real Estate Investment Fiduciaries) regions and the territory of Puerto Rico. The System shall make such investments under specified conditions and circumstances as described in this statement. The System's ability to commit large amounts of capital and long-term investment horizon give it a distinct advantage in investing in international real estate investments.~~

~~The expected rates of return shall be related to the countries selected for investment and their relative stages of development, targeted property types, relative control or liquidity or both that are associated with the real estate investment, and other structuring techniques used to mitigate taxes, if any.~~

**III. PERFORMANCE OBJECTIVE**

The performance of the investment Portfolios shall be compared to their appropriate benchmarks and target returns in excess of the minimum 5% overall real return objective for the Equity Real Estate Portfolio. These target returns may include appropriate country risk premiums specific to each country or region of investment.

**IV. III. INVESTMENT APPROACHES AND PARAMETERS**

**A. Geographic GuidelinesRisks**

CalPERS shall pursue a global real estate investment strategy. The following guidelines will apply across the entire real estate portfolio. The global universe will be divided as follows for purposes of delineating the geographic diversification of real estate investments:

<u>Region</u>	<u>Allocation</u>	<u>Definition</u>
<b><u>Developed Markets</u></b>  <u>"Developed Markets" is further bifurcated into US and Ex-US markets.</u>  <u>US</u>  <u>Ex-US*</u> <u>*investment in any one Ex-US country is limited to 20% of the total real estate portfolio</u>	<u>75%-100%</u>   <u>40%-90%</u>  <u>10%-60%</u>	<u>As defined by the FTSE Global Equity Index Series.</u>   <u>US NCREIF regions + Puerto Rico</u>  <u>Any location outside of US market as defined above.</u>
<b><u>Emerging Markets</u></b>	<u>0%-20%</u>	<u>As defined by the FTSE Global Equity Index Series as "Advanced Emerging" or "Secondary Emerging".</u>
<b><u>Frontier Markets</u></b>	<u>0%-5%</u>	<u>Countries not defined by the FTSE Global Equity Index Series as "Developed", "Advanced Emerging", or "Secondary Emerging".</u>

**B. Guidelines for Non-Developed Markets Investments**

**1. CalPERS Emerging Equity Markets Principles**

Staff and Partners shall be guided by the CalPERS Emerging Equity Markets Principles for all real estate investments in such countries. Staff shall report any such exposure on an annual basis to the Investment Committee.

**2. United Nations Principles for Responsible Investment**

For investments in developing and emerging markets, Staff shall make every effort to apply the United Nations Principles for Responsible Investments.

**3. Frontier Market Investing**

Frontier Market investing shall be allowed only if approved by the Investment Committee, with the following exception. Investments in individual commingled funds which contain strategies investing up to 10% in Frontier Markets shall be allowed and are not required to be approved by the Investment Committee.

The following factors shall be considered in assessing the attractiveness of international investing:

1. The tax treatment for the System by country and its potential impact on total return;
2. The difficulty in obtaining information regarding the behavior of private international real estate markets, and benchmarking performance;
3. Significant variance in risk and return attributes of real estate in developed countries compared with those associated with markets in developing countries; and
4. The use of leverage to minimize the tax burden often associated with international real estate investments and the direct impact this leverage has on the risk and required return of such investments.

There are unique risks associated with investment in international real estate. The primary ones are as follows:

1. The legal and regulatory environment;

- ~~2. Potential political and economic instability;~~
- ~~3. Currency exchange rate volatility;~~
- ~~4. Inconsistent building design and construction standards;~~
- ~~5. Tax policy and regulatory differences; and~~
- ~~6. Lack of reliable and consistent real estate market information and local employment and demographic data.~~

~~The mitigation of risks shall be achieved through techniques such as, but not limited to, the following:~~

- ~~1. Careful underwriting;~~
- ~~2. Legal and tax review; and~~
- ~~3. Retention of qualified experts familiar with the markets under consideration.~~

#### **~~B. Diversification Guidelines~~**

~~Given the specialized nature of international equity real estate investments, and the stated overall objective, it is not possible to mandate strict diversification guidelines for these investments. Capital allocations shall be primarily driven by market opportunities. The System shall seek to maintain a prudent level of diversification within and among such investments.~~

~~When investing in international real estate, prudent review and due diligence shall include review of political, economic, and social risks, as well as expropriation probabilities associated with the respective countries. In instances such as international commingled funds where the System may not have control over the investments, Staff will closely monitor such funds and report to the Investment Committee when such investments are at risk.~~

~~Care shall be given to avoid undue concentrations in developed or developing countries, or in any one particular country, region, or property type.~~

~~In those instances where investments are being considered in Emerging Markets, the Senior Investment Officer, (SIO), Real Estate shall have the discretion to permit real estate investments in emerging countries that obtain a favorable score, as approved by the Investment Committee, on~~

~~CalPERS' Permissible Equity Market List with the exception of the capital market factors, as updated and reviewed annually. Emerging countries that do not score favorably on CalPERS' Permissible Equity Market List, but demonstrate compelling investment rationale will require Investment Committee approval. Emerging countries that are not reviewed in conjunction with CalPERS' Permissible Equity Market List, and are deemed to have sufficient investment merits, will require Investment Committee approval. Recognizing the ability of emerging countries to fall on and off CalPERS' Permissible Equity Market List, investments will be approved for real estate investment according to the list in effect at the time of the proposed investment.~~

**C. ~~Investment Size~~**

~~The size of international real estate investments shall depend on the opportunities available to the System, with neither small nor large investments dominating the Portfolio. Additionally, investment size shall be appropriate to the projected risk/return level of the investments. However, in order to have some composite effect on the Portfolio, preference shall be given to investments with funding commitments of \$50 million or greater in size.~~

**D. ~~Structures~~**

~~The Program shall be implemented through direct equity investments in international real estate (either 100% owned or through commingled vehicles), or through publicly traded international real estate securities, or some combination thereof. Equity, leveraged equity, and hybrid investment structures are available for direct investment in international real estate by the System.~~

**E. ~~Vehicles~~**

~~The System shall consider a number of investment vehicles for investing internationally in real estate, including, but not limited to, the following:~~

- ~~1. Direct real estate equity investments in 100% owned assets;~~
- ~~2. Real estate equity joint ventures or other co-investment vehicles for real estate;~~
- ~~3. Indirect private real estate equity investments in commingled funds, private Real Estate Investment Trusts (REITs), limited partnerships, or other pooled investment vehicles;~~

~~4. Purchase of controlling or non-controlling interests of public or private international real estate operating companies;~~

~~In choosing specific investment vehicles for international real estate, the System shall consider, but not limit its options to, the following:~~

~~1. Proposed investment strategy;~~

~~2. Expected risk and return attributes of vehicles;~~

~~3. Potential exit strategies and liquidity;~~

~~4. Appropriate levels of control;~~

~~5. Monitoring costs and feasibility;~~

~~6. Potential diversification benefits;~~

~~7. Tax considerations;~~

~~8. Other incremental costs;~~

~~9. Governance and control of structure; and~~

~~10. Partners or co-investors.~~

#### **~~F. Selection of Investment Management Firms~~**

~~The System shall invest in international real estate investments on a direct or indirect basis through third party investment advisors, general partners, operating company management teams, or other organizations with specific expertise in international real estate investments (collectively referred to as "Management Firms"). Management Firms shall provide expertise and experience locating, negotiating the acquisition, monitoring, and disposing of international real estate investments. Before selection, the System shall establish and document specific relevant criteria for each Management Firm to establish the basis upon which to make the selection.~~

~~Selection of management is critical to the success of the International Real Estate Program. The System shall approve Management Firms based on their specific, successful and significant expertise (including the ability to mitigate risks identified in these markets) in locating, negotiating the acquisition, monitoring, and disposing of international real estate investments, in the particular, specific real estate market. Management~~

~~Firms shall act in a fiduciary capacity and represent only the interests of the System in these transactions or, if the System is a co-investor, only the interests of the investor or shareowner group.~~

**~~G. Asset Management~~**

~~Management Firms shall represent the System's interests in asset management decisions, providing daily property management services, as expertise and organizational structure allow. The System shall give Management Firms appropriate Delegation of Authority while requiring that they provide adequate measures of accountability.~~

~~Appropriate financial and operational controls, as well as reporting requirements applied to direct domestic equity real estate investment, shall also apply to direct international real estate investment, to the extent consistent with the investment practices of local jurisdictions where appropriate. This shall include audited financial statements on a basis consistent with the System's accounting policy where appropriate. U.S.-dollar denominated accounting and performance information shall be required.~~

**IV. BENCHMARKS**

~~The performance of the Portfolios shall be compared to U.S. equity real estate benchmarks, the NCREIF (National Council of Real Estate Investment Fiduciaries), the WRESI (Wilshire Real Estate Securities Index) indices or other benchmarks, if appropriate, and stated performance objectives. Staff and the Board's Consultant will coordinate in establishing appropriate benchmarks.~~

**VI. CURRENCY**

~~The Real Estate Unit will consider currency exposure issues with each investment and seek to mitigate currency risks. Staff and the CalPERS Board of Administration's Real Estate Consultant will coordinate appropriate strategies until and if a broader System-wide currency policy is implemented. In the interim, prior to implementation of the below, Staff and the Board's Consultant will coordinate appropriate strategies. In the longer term, the Real Estate Unit will periodically report all currency exposures to the CALPERS Global Fixed Income, International & Currency Unit (GFI). GFI may analyze currency exposures and recommend appropriate hedging strategies to the System's Chief Investment Officer and Senior Investment Officer of Real Estate. The Real Estate Unit will coordinate with GFI to implement the approved strategies.~~

**VII. GENERAL**

~~VIII. This Policy is intended for investment in international equity real estate that includes property types such as, but not limited to, the following: office, retail, apartment, industrial, residential, hotel, and lodging properties including international real estate securities.~~

**VIII. GLOSSARY OF TERMS**

Definitions for key words used in this policy are located in the Real Estate Glossary of Terms which is included in the System's Master Glossary of Terms.

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### **Developed Real Estate Markets**

Markets domiciled in high-income countries, as defined by the World Bank, that most investors consider to have a well-developed operating and regulatory structure for its capital markets. These markets are included in the FTSE Benchmark Classification as Developed Markets.

### **Emerging Real Estate Markets**

A market classified by FTSE as an emerging market based on an assessment of World Bank gross national income per capita, as well as factors related to the market and regulatory environment, custody and settlement, trading, development of a derivatives market and size of the country's stock market. Emerging Real Estate Markets are distinguished from: (1) Developed Markets which are markets domiciled in high-income countries, as defined by the World Bank, that most investors consider to have a well-developed operating and regulatory structure for its capital markets. These markets are included in the FTSE Benchmark Classification as Developed Markets. (2) Frontier Markets which are markets domiciled in low-income countries, as defined by the World Bank, whose capital market structure and regulatory mechanisms are not developed enough to be included in Emerging Markets. These are markets that are investable but not classified by FTSE as Developed or Emerging Markets. (3) Uninvestable Markets which are those markets that are not classified by FTSE as Developed, Emerging, or Frontier Markets. These markets generally lack a convertible currency and do not allow for investment by non-residents.

### **Frontier Real Estate Markets**

Frontier Markets which are markets domiciled in low-income countries, as defined by the World Bank, whose capital market structure and regulatory mechanisms are not developed enough to be included in Emerging Markets. These are markets that are investable but not classified by FTSE as Developed or Emerging Markets.

### **International**

Any geographic location other than the eight domestic U.S. NCREIF regions and the territory of Puerto Rico.

### **National Council of Real Estate Investment Fiduciaries Index (NCREIF)**

A property level performance benchmark for institutionally owned real estate. The benchmark is composed of an income return, an appreciation return and a total return and is calculated on a quarterly basis.

### **Real Estate Investment Trust (REIT)**

Refers to a private or publicly traded company which typically invests in income-

producing properties and which qualifies as an REIT under Sections 856-860 of the Internal Revenue Code of 1986. As an REIT, a company must distribute to its shareholders at least 95 percent of its taxable income and is not subject to federal (and typically state) income tax to the extent income is distributed, among other requirements.

**WRESI**

Wilshire Real Estate Securities Index.